CHAPTER TWO

Economic Globalization: *Stability or Conflict?*

What are the implications of economic globalization for international security and U.S. foreign policy? Is it making the world more prosperous, democratic, and stable, or more polarized and prone to conflict? What trends and perspectives do U.S. policymakers need to understand?

The theme of this chapter is that economic globalization is broadly consistent with U.S. international security and foreign policy interests. It facilitates integration, promotes openness, encourages institutional reform, and fosters a nascent international civil society. But shocks associated with rapid globalization, especially short-term financial flows, can exacerbate political and social problems, foment instability, incite anti-Americanism, and widen gaps within and between countries. U.S. policy must sift and weigh these opportunities and dangers.

The New Challenge

"Globalization" means a process of making something worldwide in scope. Limited versions of it have existed since ancient times. Means of transmission have included trade, conquest, study of the classics, and religious zeal. In the last two decades, however, globalization has intensified and accelerated social, political, economic, and cultural change in ways that add up to a difference in kind.

This chapter focuses on economic globalization and its relationship to national security. Economic globalization is spreading at an uneven pace, but wherever it develops, it has important security implications. It blurs national boundaries and erodes the power of nation-states, even as it extends their sovereignty into new areas. It changes regional and international power relationships, shifts the mixture of interests at stake, and redefines long-standing alliances and conflicts. It will greatly influence the shape, content, and legitimacy of the future global security order. For these reasons, the U.S. national security community has an important stake in U.S. international economic policy.

Several potential threats described in *Strategic Assessment 1995* have not come to pass and are unlikely to do so. Closed regional blocs have not emerged. Zero-sum rivalry in high technology, if it exists at all in a global economy, has clearly shown the United States to be a successful competitor and beneficiary. Foreign investment in key U.S. industries has not opened the door to threats and blackmail.

Economic Globalization

"Globalization" means the process of making something worldwide in scope and application. It most commonly refers to the stunning increase in the number and variety of transnational transactions, dimly foreshadowed in the years leading up to World War I, that has marked the last two decades.

The process of adapting to global conditions requires adjustments on the part of both producers and consumers. Economic columnist Robert Samuelson defines globalization as "the worldwide convergence of supply and demand." Similarly, financial guru George Soros refers to the global economy as a "gigantic circulatory system." This convergence or system takes many forms:

- Trade (goods, services)
- Finance (banking, investment, foreign exchange, capital movements)
- Communication (information, education, technology)
- Governance (institutions, regulations, norms, threats)
- Culture (art, music, entertainment) and
- Work and leisure (labor, migration, tourism).

Economic globalization refers primarily to the first two, but it both influences and is influenced by all the others.

At the same time, forces associated with economic globalization have threatened near-term stability in several key countries, aggravated social and economic tensions, and increased the potential for backlash against globalization at home and abroad. Certain entire regions—with their high concentration of "rogue" regimes and troubled states—seemingly lack the ability to compete in the global economy and may lapse or relapse into hostility and sporadic aggression.

This combination of benefits and risks bursts into full view in what is clearly the most dramatic international economic event in the last 4 years—the Asian economic crisis. Financial markets torpedoed short-term economic prospects in a region that had been experiencing 6 to 8 percent annual growth. Within 3 months after the collapse of the Thai baht in July 1997, the currencies of Thailand and Indonesia fell 30 percent against the dollar. Those of the Philippines and Malaysia fell 20 percent. By 1998, the Indonesian rupiah had lost 75 percent of its value against the dollar. Private capital flows to the region, which soared during the 1990s, suddenly plummeted, while interest rates skyrocketed. The near collapse of the Asian economies triggered riots, bank failures, real wage reductions, and unemployment. Meanwhile, in August 1998, Russia defaulted on debt payments, setting off another crisis. The global attack of nerves triggered by the further collapse of the ruble caused markets to tumble in Latin America, prompting the preparation of an emergency International Monetary Fund (IMF) loan package for Brazil as a pre-emptive measure.

Asian currencies have stabilized, and investment is slowly returning. As of mid-1999, however, currency values are still below their precrisis level, and equity prices have not recovered. Virtually every country in the region except China is in recession or near recession. The crisis has boosted the U.S. trade deficit with Asia to levels that threaten political and security cooperation.

The Asian drama is the first real crisis of globalization. It is a clash between the new realities of globalization and old ways of doing business. The disturbing aspect of this crisis was that Asian countries had been following the doctor's orders. They had opened up their economies (albeit relatively recently) and were seeking closer integration with the international economic order. They enjoyed relatively good political and security relations with the United States. What, then, are the lessons to be learned?

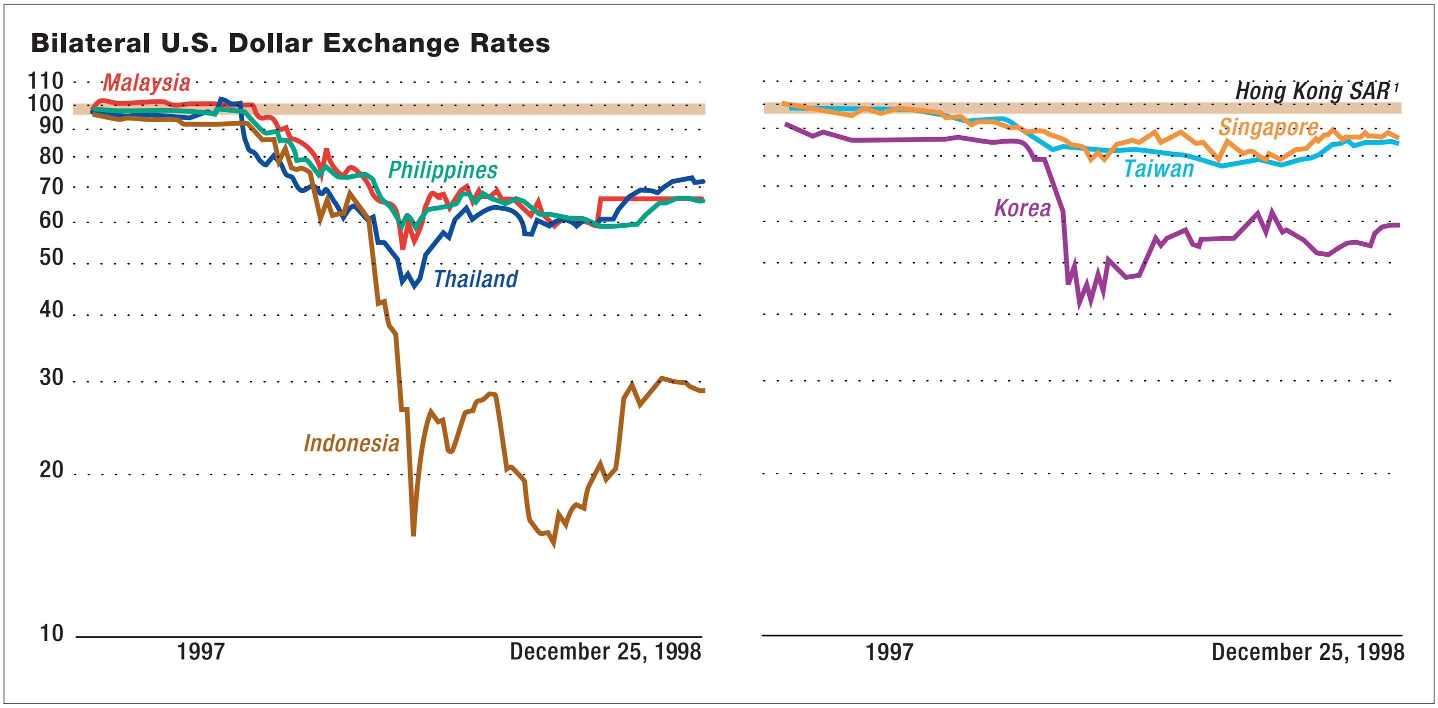
Asia's economic and political turmoil stems primarily from domestic political and structural weaknesses, but globalization subjected those weaknesses to unprecedented strains. While globalization spurred high growth rates in most of the region, it facilitated waves of short-term borrowing and investment in dubious projects. The financial sector was particularly weak and poorly regulated, and social safety nets were wholly inadequate to deal with the crisis. But the international community's reactions made the situation worse. Unwise investors panicked and fled, and the IMF initially imposed unduly harsh policies.

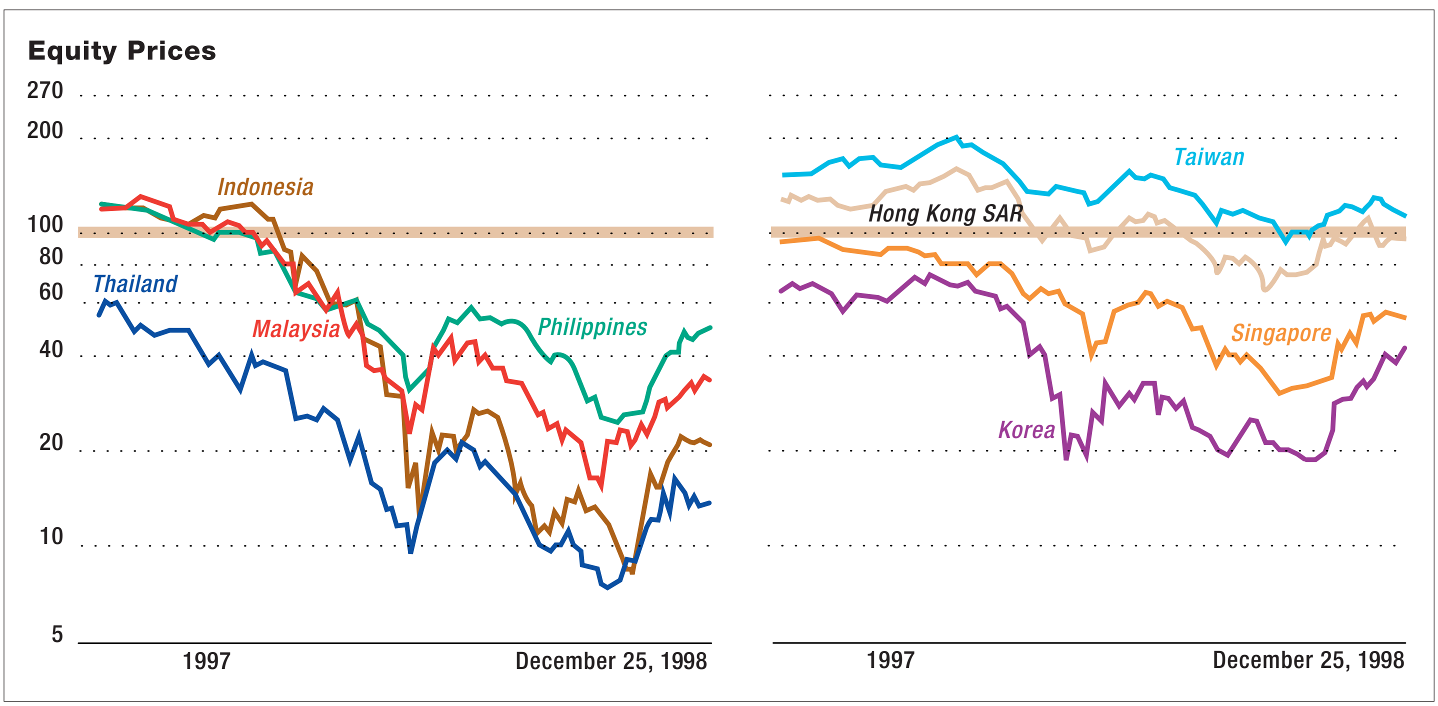
Drawing on this experience, the United States should attempt to channel economic globalization in ways that minimize pain and maximize stability. This chapter seeks to identify defining trends, U.S. interests at stake, and ways of coping with globalization more strategically and effectively.

Key Trends

During the Cold War, the United States consciously pursued its own version of globalization. It sought to integrate and expand the democratic, market-oriented, Western or pro-Western community of nations. This community-building strategy encompassed both security and economics. The security component created a Western alliance system anchored in containment, deterrence, and collective defense. The economic

Selected Asian Economies: Bilateral U.S. Dollar Exchange Rates and Equity Prices

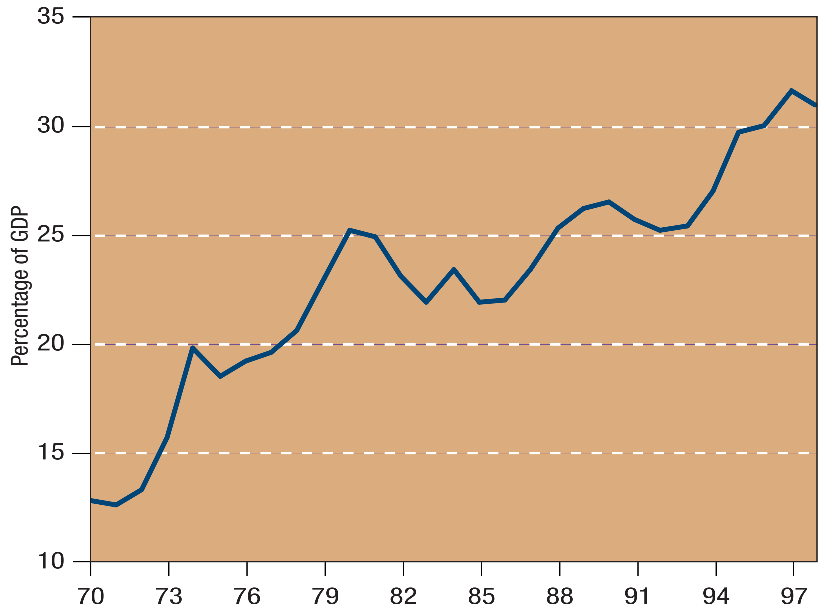




[1] Pegged to U.S. dollar.

Source: Bloomberg Financial Markets, LP; International Finance Corporation; and Reuters.

Growing Importance of Trade in the U.S. Economy



Note: Earnings on foreign investment are considered trade because they are conceptually the payment made to foreign residents for the service rendered by use of foreign capital.

Source: Office of the U.S. Trade Representative, derived from U.S. Department of Commerce data.

component established a cooperative, rules-based trading system that rejected protectionism and lowered trade and investment barriers. Both components encouraged the notion that cooperation serves national interests better than conflict. Both stimulated greater efficiency, which freed up military and economic resources for more productive investment.

In the post-Cold War era, this dual policy of expanding economic and security cooperation remains the main U.S. policy instrument for building a just, stable, and prosperous world order. Global economic opportunities are fostering several positive trends. These include the further development of rules and institutions and the emergence of an international civil society. However, rapid economic integration can also foment short-term political instability, stir up hostility toward globalization, and fuel anti-Americanism, all of which threaten U.S. national security interests.

Globalization of Trade and Investment

The current integration of markets stems from a new pattern of global business. Liberated by breakthroughs in transportation and information technology, companies are increasingly dispersing their operations around the world. By some measures, such investment is more important than trade. According to the most recent data (1995), local sales of overseas affiliates of U.S.-based firms exceeded U.S. exports. Financial services companies have made a similar transition. This dispersal of the various phases of the product or service cycle among different countries encourages economies of scale and permits adaptation to local markets. At the same time, it increasingly gives rise to world-class standards of performance, quality, and efficiency.

Since 1970, U.S. trade and investment have grown more than twice as fast the gross domestic product (GDP). In this period, such flows have mushroomed from the equivalent of 13 percent of GDP to over 30 percent. Since 1992, exports have accounted for at least one-third of economic growth and two-fifths of new jobs. Productivity in the export sector is about 20 percent higher than the U.S. average, and firms that export are less likely to fail. Both investment from abroad and U.S. investment overseas are closely linked with trade and employment. European investment alone supports 12 percent of U.S. manufacturing jobs.

A parallel aspect of globalization is the increased opening of domestic markets to forces of international supply and demand. The need to compete in a global economy is forcing governments to open their markets, undertake wide-ranging deregulation, and privatize state-owned enterprises. Many governments that were previously anti-Western are now competing for foreign investment. The only exceptions are "rogue" governments whose policies violate international norms and whose economies are correspondingly barren.

Global and Regional Trade Institutions and Rules

Along with the globalization of business, trade institutions and rules are becoming stronger, and their scope has expanded well beyond tariffs and quotas. Broadly defined, trade rules encompass not only imports and exports of goods and services but also such areas as trade-related investment, intellectual property protection, subsidies, and other domestic policies affecting market access. Worker rights, environmental protection, and competition policy are also being discussed in trade fora. Economic integration is creating new rules, norms, and expectations.

The central institution of the global trading system is the World Trade Organization (WTO) in Geneva. Created as a successor to the General Agreement on Tariffs and Trade (GATT), the WTO now includes over 130 members, with some 25 (including Russia and China) waiting to join. Current WTO rules and levels of liberalization are the result of a series of prior multilateral negotiations, known as "rounds." The most recent was the Uruguay Round, which significantly broadened the scope of trade rules. Concluded in 1993, the Uruguay Round further reduced tariff and nontariff barriers, established meaningful disciplines on agricultural trade, set down modest limits on trade-related investment measures, and defined for the first time agreements to govern services and trade and protect intellectual property.

Uruguay Round negotiators also committed themselves to a so-called "built-in agenda"—a set of discussions scheduled for 1999 and 2000 that will review progress in many of the important sectoral and functional areas. Another comprehensive round of multilateral trade negotiations will be launched after the turn of the century. Such rounds are needed to balance the interests of all WTO members and facilitate trade-offs among issues and sectors.

From a national security perspective, the most important achievement of the Uruguay Round was a much stronger dispute settlement system. Under the new rules, a country accused of nullifying another country's rights under the WTO cannot delay an investigative finding by an independent panel of experts. The country found to be in the wrong can appeal, but if the finding is sustained it must withdraw the offending barrier or offer compensation.

Below the WTO, a large and growing network of regional trade agreements has sprung up. Roughly two-thirds of world trade now takes place within free trade areas or among countries committed to free trade and investment by a certain date.

Regional trade agreements have become an important geopolitical expression of postwar relations among states. They combine the logic of geography (contiguous territories or a shared body of water facilitating trade) with common political interests. Possibly for that reason, trade within these regions has expanded beyond what size and distance would predict. Major examples include the European Union (EU), the North American Free Trade Agreement (NAFTA), the Association of Southeast Asian Nations (ASEAN), the Asia-Pacific Economic Cooperation forum (APEC), and MERCOSUR (the Southern Cone Common Market, comprising Brazil, Argentina, Uruguay, and Paraguay, with Chile and Bolivia as associate members). The same pattern is likely to occur in the proposed Free Trade Areas of the Americas (FTAA). The United States is geographically well positioned to participate in three of the most important regional trade agreements, NAFTA, APEC, and the FTAA.

In some cases, regional trade agreements also represent a conscious effort to overcome political tensions, reduce the likelihood of military conflict, and initiate or strengthen security ties. For example, the creation of the former European Economic Community (now the EU) was intended to preclude war between France and Germany. APEC includes China and Taiwan as well as Vietnam. ASEAN has established a regional forum to discuss security issues with the major powers.

The one challenge to U.S. influence is MERCOSUR. Brazil, the unofficial leader of the group, is attempting to strengthen MERCOSUR as an alternative to the U.S.-dominated NAFTA, possibly to the detriment of the FTAA. MERCOSUR also plans to sign trade-expanding agreements with Andean nations and the European Union, both of which would discriminate against U.S. exports. The first summit between Latin American nations and the European Union is scheduled for 1999.

The United States is not currently in a good negotiating position to counter these geopolitical and commercial developments, because Congress has refused to grant the Clinton administration's request for renewed trade agreement authority known as "fast track." Nevertheless, future trade relations between the United States and MERCOSUR are likely, on balance, to be positive. This conclusion is based on the size of the U.S. market, the ongoing Brazilian reform process, the imperatives of economic integration, and the demonstrated MERCOSUR commitment to democracy.

The missing link is a transatlantic trade agreement. Since the transatlantic trade agenda is

AP/Wide World Photos

Bank of China advertisement for the euro

increasingly global, however, such a preferential transatlantic free trade agreement or "TAFTA" would not make sense. The "Transatlantic Marketplace" announced at the 1995 U.S.-EU summit in Madrid initiated a modest but practical set of measures, particularly a package of regulatory agreements designed to eliminate duplicative test and certification requirements. In 1998, a more ambitious proposal advanced by European Commission Vice President Sir Leon Brittan was vetoed by the French. However, a limited version of the proposal is being pursued under the heading, "Transatlantic Economic Partnership."

Concern has arisen that regional trade agreements will have a disintegrative effect on the world economy and slow momentum for global free trade through the WTO. Thus far, however, such agreements have stimulated free trade, enhanced liberalization, and challenged other regions to follow suit. Far from detracting from the WTO, regional trade agreements have raised the sights of the global trade community.

Integrated and Responsive Financial Markets

The globalization of finance differs from globalization of trade and investment in at least three ways. First, its fluidity and speed are unprecedented. Second, it can be destabilizing in the near term, thus undermining established political patterns and interests. Third, it often has a "contagion effect" on other countries. U.S. Federal Reserve Chairman Alan Greenspan acknowledges that this effect increases systemic risk, because one country's mistakes tend to "ricochet" through the entire global financial system.

The volume of money washing around the world is enormous. New financial instruments set up to attract and guide these flows have proliferated. One such instrument is a hedge fund. Thirty years ago, no more than $2 billion were invested in hedge funds. Today, hedge funds contain $200 to $300 billion. Compared to the estimated $3 trillion in mutual funds, these numbers seem small, but hedge funds, which are unregulated, can be destabilizing because they borrow far more than they can buy (that is, they "leverage their capital"). They also trade in options and futures contracts. One of the largest, Long-Term Capital Management, had investments that may have amounted to several hundred billion dollars. Its near-collapse in summer 1998 prompted the Federal Reserve to mobilize private support to save it.

A related instrument is derivatives, the buying and selling of options to protect against risks. Standardized derivative contracts are regulated, but many other contracts are tailored for specific parties and are not regulated. The paper value of the underlying financial products used to create privately traded derivatives contracts is estimated to be $37 *trillion,* up from $865 billion in 1987.

Global financial markets can be extremely punitive. They propel huge amounts of capital around the world and withdraw support from unstable currencies and economies without warning. According to the World Bank, indirect evidence links capital inflow surges with subsequent banking and/or currency crises (e.g., Argentina, Brazil, Chile, Mexico, and Venezuela, as well as the current sufferers in Asia). No one can predict exactly when investors suddenly lose confidence, but when they do, they stampede as a herd. Once panic sets in, people living at or near the margin face misery and near-ruin. The middle class suffers sudden loss of income and unfulfilled expectations.

This destabilization stems in part from sheer speed in financial markets. Flashes of data around the world intensify the volatility of currency movements and can send stock markets spiraling within minutes. Currencies can be withdrawn nearly instantaneously, and flows can be large enough to overwhelm government policies. Except perhaps for energy sources, no other commodity can affect a nation the way the

The IMF Debate

The IMF response to the economic crises in Asia and Russia has stirred up controversy and debate. Defenders of the IMF assert that the combination of major loan packages and strict conditions has stabilized currencies and promoted recovery. Critics have put forward a variety of perspectives. Some believe that large rescue packages encourage irresponsible behavior on the part of governments and bail out reckless private investors (what economists call "moral hazard"). Others believe that the stringency of IMF loan terms has imposed undue hardship, is culturally or politically unsuitable, and will trigger an anti-West backlash.

Massachusetts Institute of Technology economist Paul Krugman has criticized the IMF for what he calls a "gratuitous deflationary policy" that worsened the recession in Asia. He favors what he calls "Plan B"—imposing temporary foreign exchange controls and cutting domestic interest rates to restore growth. Jeffry Sachs of Harvard has also argued that IMF insistence on higher interest rates has unnecessarily prolonged hardship in Asia. A real-life example of this "soft-money" school is Prime Minister Dato Mahathir of Malaysia, who has imposed highly controversial capital controls.

Several economists and former U.S. Cabinet officials ranging from Milton Friedman to George Shultz favor abolishing the IMF altogether. They believe it has become irrelevant in a world in which private capital flows are dominant. Martin Feldstein does not go that far, but he would have the IMF focus exclusively on liquidity and access to capital markets rather than force structural and institutional reform. Allan Meltzer of Carnegie Mellon University would transfer the IMF "lender of last resort" function to the Bank for International Settlements in Basle, Switzerland. Sebastian Edwards of UCLA would replace the IMF with three smaller institutions: one to provide information on countries' financial health, one to help prevent crises by providing contingent credit lines to "good" countries, and the third to deal with restructuring and cleaning up after a crisis has hit.

Other economists favor complementing the IMF with new or partially transformed international bodies. Financier Henry Kaufman urges the creation of a new international institution to oversee and set standards for bank capital, accounting, training, reporting, and disclosure. Economist Alice Rivlin of the Federal Reserve has proposed a new certification system by an independent international organization. This body would rate the quality of bank supervision, bankruptcy administration, and the conditions of financial institutions in various countries to signal the degree of risk.

Still others advocate reforms within the existing system rather than new or revised institutions. The Institute of International Finance, a global association of financial institutions, has called for greater "transparency" (openness) in IMF operations, a collaborative surveillance mechanism to prevent crises, a clearer division of responsibilities with the World Bank, and greater communication and cooperation with the private financial community. Economist and former IMF official Morris Goldstein of the Institute for International Economics urges the IMF to require countries to implement and enforce higher capital standards for their banks, to adopt the Basle Committee's Core Principles for Effective Banking Supervision, to introduce an effective bankruptcy system, to establish deposit insurance systems that give priority to small depositors, and to adopt various other reforms.

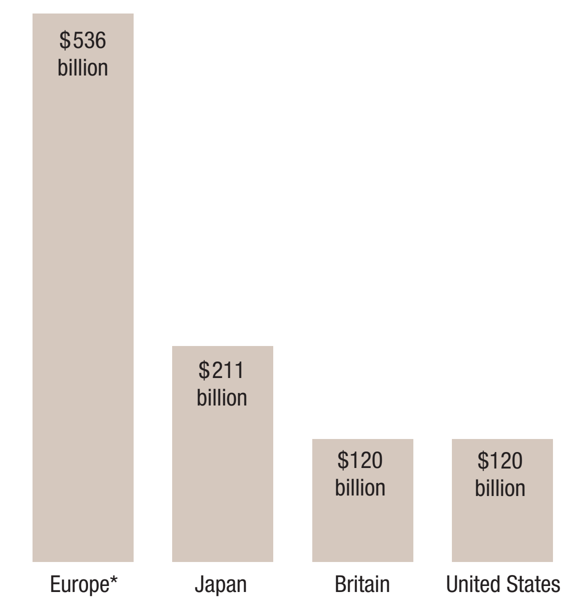
The IMF itself has responded vigorously to these charges. It has conceded that it failed to foresee the scale of the financial contagion that followed the Thai crisis, and it admits to serious failure in Russia. It has also modified some of its more austere requirements, especially those affecting the poor. But it strongly defends its effort to help countries maintain access to international capital markets by implementing essential macroeconomic and structural reforms. It denies the charge that its policies have shielded private investors from loss. It has called for improvements in six major areas: (1) more effective surveillance over countries' economic policies and practices, facilitated by fuller disclosure of all relevant data; (2) financial sector reform, including better regulation and supervision; (3) ensuring that the process of opening economies to inward and outward flows of private capital is orderly and properly sequenced; (4) promoting regional surveillance; (5) a worldwide effort to promote governance and fight corruption; and (6) more effective approaches to debt restructuring, including better bankruptcy laws and closer collaboration with private sector creditors.

flow of money can. Goods can be substituted, stockpiled, or even seized, but financial confidence can never be totally controlled or replaced.

Not all sudden financial swings are politically destabilizing. They only undermine medium- and long-term stability when latent political weaknesses are exposed and seen as creating undue risk. Ministers may resign, but no amount of currency speculation can overthrow a government that has legitimacy in the eyes of its people and pursues policies in line with its resources. Elected leaders, such as President Fernando Cardoso of Brazil and President Kim Dae Jung of South Korea, face enormous problems, but they are in a better position to push through reforms than handpicked oligarchs, who lack democratic legitimacy and popular support.

In the wake of the Asian crisis, the IMF is under heavy attack for its seeming indifference to the social consequences of its austerity policies and its failure to cope effectively with Russia. The IMF admits that it was unprepared for the magnitude and spread of the Asian crisis. It also concedes that funds provided to Moscow were largely wasted. While it has softened its demand for certain austerity measures, it defends measures to stabilize currencies and points out that severe inflation is devastating for the poor.

Where the Money Comes From . . . Loans to Emerging Markets



* The 11 European nations that have adopted the euro: Austria, Belgium, Finland, France, Germany, Ireland, Italy, Luxembourg, Netherlands, Portugal, and Spain.

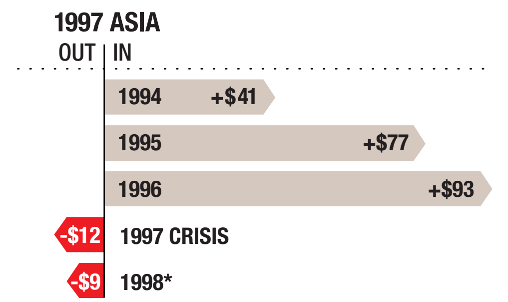
Sources: Bank for International Settlements; Institute of International Finance; International Monetary Fund.

Regardless of real or perceived IMF mistakes, it is clear that IMF willingness to stand behind national governments promotes stability by reassuring investors. If the IMF did not exist, it would have to be invented. For the United States in particular, the IMF presents one of the few remaining opportunities to pursue foreign policy initiatives without undue political interference. But the Asian crisis suggests that the IMF and the World Bank will have to pay more attention to such factors as the institutional health of the banking sector, political stability, and social safety nets than they have in the past.

Trade and Financial Recovery

Over time, the two primary manifestations of economic globalization—the global and regional trading system and the international financial system—reinforce each other in beneficial ways. The reforms demanded by each are mutually supporting and often overlapping. The rewards of good performance are closely related. Correcting financial problems benefits trade and investment prospects, restores confidence, and places exchange rates on a sounder footing. Free-trade agreements can limit damage and accelerate recovery from financial crises.

. . . And What Happens When It Dries Up
(Billions $)



* The 13 hardest-hit countries: Argentina, Bolivia, Brazil, Chile, Colombia, Ecuador, Ivory Coast, Nigeria, Mexico, Morocco, Paraguay, Peru, and Venezuela. Estimated.

Sources: Bank for International Settlements; Institute of International Finance; International Monetary Fund.

In the case of Mexico, NAFTA accelerated recovery from the 1994–95 peso crisis. It restored investor confidence and helped justify the U.S. assistance package to critics in the Congress and elsewhere. Mexico upheld its NAFTA obligations, thus protecting U.S. commercial interests. After a similar crisis in 1982, it took 7 years for U.S. exports to regain their previous level. This time U.S. exports recovered in just 19 months.

Similarly, the trading system is likely to serve as a catalyst for the reconstruction of the economies of the Asia-Pacific region. As in Mexico, the Asian crisis stemmed from weaknesses in the financial sector, political uncertainties, and problems in the external sector. But Asian countries' strong track record in and commitment to the trading system, as seen in APEC, will contribute to reform and recovery. Far from retreating into protectionism, those countries that have been hit hardest have reiterated their commitment to trade and investment liberalization—even though the severity of the present crisis has stalled actual progress toward that goal.

Global Information Boom

As companies disperse their business operations around the world, information moves with them. Along with the revolution in transportation, the explosion of information technology speeds and intensifies the globalization of trade and finance.

The global information boom has created a new universe of users. The number of people connected to the Internet is increasing exponentially, from an estimated 10 million in 1995 to 140 million at the end of 1998. Some experts believe that there will be as many as 1 billion Internet users by 2005. Even North Korea operates a web site from Tokyo. Globalization has been pulled downward, literally into the lap(top)s of individuals.

The information boom has also sparked a whole new form of business—electronic commerce, or "e-commerce." The international information flow is expanding beyond large corporations and banks to local retail establishments, interest groups, nongovernment organizations, and households. Operating from home with a few thousand dollars worth of equipment, anyone can become a global merchant. The volume of sales over the Internet more than doubled between 1997 and 1998.

The sudden pervasiveness of this new technology raises issues that negotiators have never faced before, such as commercial practices, privacy, liability, and censorship. For example, what constitutes a valid electronic contract? What authority will enforce such contracts? Globalization has propelled a number of these hitherto domestic or nonexistent issues upward to the multinational level, where new rules are being debated.

The impact of information technology is by no means limited to commerce. Global networking is mobilizing nonstate actors and facilitating the emergence of an international civil society. Activists who tap into the global information system also communicate horizontally with each other through electronic mail. More and more people whose lives are affected by what governments decide can now make their voices heard through cross-border coalitions.

Business representatives have long enjoyed access to government officials. What is new is the number of nonprofit groups that seek a similar role. Fifteen years ago, for example, only a handful of nonprofit organizations tracked multilateral trade negotiations. More than 150 such groups attended the 1990 conclusion of the Uruguay Round in Geneva, and 250 attended a 1998 ministerial meeting. Some of them lobbied successfully to put environmental protection and worker rights on the negotiating table and to defeat a proposed agreement on investment then under discussion in the Organization for Economic Cooperation and Development (OECD). Similarly, the number of nongovernment organizations accredited to the United Nations has risen from 41 to over 1,500. These groups can point to some tangible achievements, such as the first environmental summit in Rio de Janeiro, the treaty to ban land mines, and the establishment of an international criminal court.

Instant communication complicates diplomacy, because it erases the line between domestic and foreign audiences. Many a politician has made off-the-cuff remarks about foreigners to domestic constituents only to find that his words have mushroomed into a diplomatic incident. Precisely for that reason, the media's presence makes it hard for governments to get away with gross violations of international norms. Thanks to the Internet, newly mobilized nongovernment groups routinely exchange information on conditions in their respective regions. Some maintain contact with dissidents living under repressive regimes and draw international attention to their fate. Others bring global pressure to bear on pollution and environmental destruction.

Some leaders and activists resort to entertainment channels to advance their agenda. The line between news and entertainment is blurring. In 1997, at least two new movies raised public awareness about the Chinese Communist suppression of Tibetan culture. In mid-1998, young Americans flocked to the "Tibetan Freedom Concert" in Washington to learn about Tibet for the first time.

The fact that the United States is the largest producer of entertainment with an appeal to global audiences has economic and political advantages. The entertainment industry is one of the top contributors to U.S. export earnings. Not only do American films, television programs, and popular music sell widely abroad, they also spark consumer demand for U.S.-style clothing, footwear, cosmetics, and accessories. The political effect—admittedly difficult to prove—is that many forms of U.S. entertainment transmit American norms and values around the world. To a degree, the image of the American lifestyle may inspire young people to press for greater freedom and opportunity in other countries.

Globalization's Disintegrative Effects

Globalization demands efficiency. It accelerates technological change and forces societies and individuals to adapt economically, politically, and psychologically. It rewards those who are prepared for it and punishes those who are not. It undermines traditional forms of national sovereignty and causes citizens to fear loss of control. It can unleash centrifugal forces that work against global integration, foster a political backlash, and threaten U.S. interests. These risks are particularly acute in certain countries and regions.

One of the trends associated with globalization—rightly or wrongly—is the widening income gap within individual countries. Economists differ on how to define and measure wage and income gaps, but they exist in several forms. In the United States, the spread between the first-time wages of U.S. high school graduates and college graduates is growing. The share of wealth held by the richest 1 percent of the population is climbing. Several factors contribute to this trend: the stock market boom, rising demand for skilled labor, the entry of women into the work force, and high levels of immigration, to name a few. Most economists estimate that these factors account for a far greater share of the income gap than global trade and investment.

In some sectors, globalization acts as a catalyst and shortens the time available for competitive adjustment. A number of people in the United States are unprepared for the transition. Already on the wrong side of the income gap, they lack skills to find jobs in globally competitive industries. Others have held good jobs in large companies, only to find themselves laid off with no prospects. Between 1979 and 1995, for example, U.S. employment in Fortune 500 companies shrank from roughly 16 million to 11.5 million. Factories employing two or three generations of workers closed down. Many of these workers either remain unemployed or suffered major income losses.

In the United States, these risks have fostered a well-organized resistance to further global engagement. Many nongovernment groups see globalization as serving large corporate interests at the expense of the poor. Domestic opposition of this sort hinders the fulfillment of U.S. commitments and thus undermines U.S. credibility abroad.

If globalization strains the social and political fabric in a rich country like the United States, it is not hard to imagine its effects elsewhere. Growth rates are higher for those developing countries that engage successfully in global trade and investment than for those that do not. But macroeconomic statistics do not tell the whole story. Within those societies, unjust policies and widespread corruption often stretch the income gap to extremes.

Another trend associated with globalization is heightened ethnic conflict. Globalization does not cause ethnic tensions, but the publicity associated with the global information age can inflame them—especially if class lines coincide with ethnic divisions. News of atrocities spreads quickly, not only around the world but also among long-standing enemies. For example, government-controlled media fanned ethnic hatred in both Rwanda and the former Yugoslavia. From the victims' perspective, globalization makes it easier to bring a grievance to the world's attention and appeal for international support. Unfortunately, such publicity does not appear to reduce the likelihood of slaughter. Neither mobs nor roving bands of soldiers worry much about their international image.

Globalization and Anti-Americanism

Although economic globalization is not the same as Americanization, it is largely driven by Americans. U.S. companies are at the forefront of global trade, investment, finance, and information technology. Companies like Levi Strauss, McDonald's, and Walt Disney invent the icons; CNN and Hollywood transmit them. Europeans and Japanese contribute substantially to globalization, but their logos are not so visible.

This U.S. dominance is a mixed blessing. The United States is perceived around the world as a rich, invincible, hegemonic superpower. Resentment is a natural reaction, even when it is mixed with admiration. Washington has often been blamed for other people's grievances, and it will continue to be a target. This is the price of highly visible wealth and power. But the combination of globalization, the booming U.S. economy, and the media revolution intensifies the criticism. The high level of U.S. consumption embitters environmentalists and others who are concerned about protecting global resources and indigenous peoples. The social and economic strains associated with globalization give rise to the charge that the United States is advancing its own commercial interests under a global banner at the expense of the poor.

Such accusations can race around the world on television and through the Internet. The backlash against globalization can quickly turn anti-American. In many countries, this backlash seeks scapegoats and inhibits further economic liberalization. In Indonesia, anti-Chinese mobs looted Chinese stores, but some resentment was directed against U.S. citizens, who were perceived to be influencing the IMF. Ethnic or religious leaders often exploit anti-Americanism to strengthen their position at home, as Prime Minister Dato Mahathir of Malaysia has done. Europeans and Japanese do not face this problem.

Similarly, the overwhelming U.S. dominance in information technology and entertainment can be too much of a good thing. Societies with a fragile sense of identity and culture can be overwhelmed by the seeming flood of on-screen sex, violence, and lack of respect for authority. In some countries, such values as respect for the individual, women's rights, and freedom of expression are associated with U.S.-imposed "cultural imperialism" and rejected accordingly.

Globalization of Crime

Another dark side of economic globalization is that it facilitates international crime. Electronic communication has jumped international police roadblocks and facilitated the spread of terrorism, money laundering, and narcotics trafficking. The growing threat of electronic terrorism has also alarmed the national security community. U.S. law enforcement officials have tried to limit the export of high-performance encryption devices in order to be able to read electronic mail in criminal investigations. However, such devices are now built into standard U.S. information technology products and are also available abroad. On the positive side, police officials in different countries can cooperate with each other more effectively thanks to the same technology.

"Globalization Gap"

The uneven distribution of wealth associated with rapid globalization may be widening the gap between certain countries and regions. A rising economic tide lifts all nations, but only if they are structurally sound. In order to prosper in the newly globalizing economy, nations must possess the core foundation of competitiveness.

A competitive foundation is difficult to define precisely. At a minimum, it must include the freedom to engage in market activities without fear of arbitrary arrest or ethnic reprisal. Such tolerance requires a certain level of civic trust and a willingness to set aside age-old tribal or ethnic conflicts. In addition, competitiveness depends on the rule of law, respect for education, a good work ethic, willingness to save, and a sound macroeconomic policy.

The distribution of competitiveness is currently uneven. Countries that lack this foundation tend to be concentrated in the Greater Middle East and sub-Saharan Africa, and perhaps in the former Soviet Union. This pattern raises the disturbing prospect of a growing "globalization gap" between winners and losers—the regional, geopolitical equivalent of the widening income gap. Leaders of the losers often blame outsiders or unpopular insiders for economic hardship. Some foment crises to distract domestic attention from joblessness and hunger.

These conditions make it difficult for the West to pursue its dual strategy of security and economic community building. While noncompetitive countries may be members of the WTO, they lack the fundamentals to attract healthy investment. They also lack the minimum prerequisites for collective security, such as shared values and a willingness to pool military resources for the sake of the common good.

Nevertheless, there is reason to hope. The information revolution enables even those under dictatorships to learn about what their country should do to prosper. For decades, *caudillos* (bosses), red tape, and corruption gripped Latin America. Today, the region has turned decisively in the direction of free markets and democracy. Asia is in the grip of the worst recession since World War II, but it has remained relatively stable, despite several serious points of tension (e.g., the Korean peninsula, the Taiwan Strait, and the Spratly Islands).

U.S. Interests

In today's world, U.S. international economic interests and U.S. national security interests are not only broadly compatible; to a great extent they are also mutually reinforcing, because the structural conditions associated with enhancing security overlap substantially with those promoting prosperity and advancing democracy. They include market-oriented macroeconomic policies, a sound and transparent financial system, a functioning legal system, an accountable political system, civilian control of the military, respect for human rights, observance of labor standards, concern for the environment, a peaceful foreign policy, and participation in rules-based international institutions.

On balance, globalization works in favor of these conditions. The free flow of trade and investment raises incomes, dampens inflation, and creates new stakeholders in a growing economy.

Right Makes Might

Although power remains important in world politics, globalization has transformed its character, correlates, and consequences: Power now depends on freedom.

The essential reason for the new correlation of freedom and power lies in the *nature* of information technology: It springs from and adds to human knowledge. It has proven to be the best way yet found to release human potential. State power cannot produce and can even retard this technology. The information revolution liberates and requires liberation. The *nature* of this technology, not just its stage of development, favors open economic systems.

The need for and effect of information technology will cause rising powers to gravitate toward the interests, ways, and outlook of the United States and the democratic core, rather than to challenge them. Otherwise, even giant states, though potentially dangerous—rogues on steroids—will be chronically malnourished in the dominant technology. They will remain on the outskirts of not only the global economy but also the power structure of world politics. Paradoxically, although globalization diffuses power, it also strengthens its agents—the large free-market democracies that command the dominant technology.

Hostile states will surely develop countervailing capabilities and tactics. But the essential point remains: superior information can provide a transcending military advantage, which the countries strongest in the essential technology will enjoy.

The mobilization of military power in the information age, more so than in the industrial age, will depend on the technological vitality of the civilian economy and the ability of the military to be able to absorb that technology and draw on that vitality quickly. It will thus depend on the degree of economic and political openness of the society and the extent to which those ways have been introduced into the military establishment. There is more power inherent in a democracy—not in the state but in the nation. Information technology is key to harnessing it.

Globalization and its prime mover, information technology, are producing a growing commonwealth of great powers—compatible in outlook and ideals, unafraid of one another, eager for all to succeed, and confident enough to welcome change and other powers.

Source: David C. Gompert, *Right Makes Might: Freedom and Power in the Information Age,* McNair Paper 59 (Washington: National Defense University Press, May 1998).

The freedoms associated with more open markets sweep away the remnants of leftist ideology, strengthen common interests and values, and reduce the likelihood of external aggression. The opportunities associated with trade and investment are more appealing than military ventures and irredentism. A rising business class is more likely to favor investment in new roads than in combat aircraft. Young people are more likely to be interested in jobs and entertainment than age-old territorial disputes. More jobs mean fewer people on the streets to engage in anti-American demonstrations and ethnic violence.

These trends are not obvious at first sight. On a daily basis, globalization and security appear to operate at cross-purposes. National security is based on the notion of territory controlled by the nation-state, while globalization transcends national borders. As the Asian crisis illustrates, the U.S. national security community is relatively helpless in the face of short-term financial crises exacerbated by globalization. Similarly, globalization makes it harder to carry out unilateral economic sanctions against rogue regimes.

A variation of the alleged contradiction between globalization and security is the notion that economic strength has replaced military strength as the measure of global power. This implies that these two manifestations of power are qualitatively different and that the shift from one to the other is irreversible. Yet media headlines illustrate that military power is a key component of America's profile in the world and defines its status as a global superpower.

A more nuanced interpretation of the shift in power relations is that to a greater degree than before, *national security depends on successful engagement in the global economy*. This is true whether national security is defined broadly, in terms of the global security environment, or narrowly, in terms of the manufacture and operation of high-quality, low-cost weapons systems. David C. Gompert of the RAND Corporation argues specifically that mastery and development of information technology—and the openness and creativity associated with it—now constitute the core of military power (see box).

To enhance the likelihood of successful engagement in the future, U.S. policies designed to promote economic globalization should be based primarily on three broad international interests: strengthening and deepening the multilateral trading system, enhancing global financial stability and growth, and promoting sustainable development.

Strengthening and Deepening the Multilateral Trading System

In the closing days of World War II, a small group of nations gathered to establish the General Agreement on Tariffs and Trade (GATT). Mindful of the disastrous economic history of the 1930s, statesmen clearly recognized that a rules-based, market-oriented multilateral trading system contributes to prosperity and peace. The GATT system became a pillar of postwar stability.

There are at least two broad reasons why the global trading system still reinforces stability. First, membership in the WTO (successor to GATT) and in the major regional free trade arrangements can be thought of as *economic confidence-building measures.* The rules require governments to consult with each other regularly and inform fellow members of changes in national laws and regulations. Governments must also abide by the results of dispute settlement procedures. By imposing greater discipline on national behavior, these procedures can act as a check on special interests. Together with the European Union, the United States is one of the most active users of the dispute settlement system. Small countries also have a stake in the system, because they can and do win cases against big ones.

Second, the international trading system promotes *openness and accountability.* Governments must acknowledge and publish the practices that interfere with the market, such as subsidies and quotas. Investors must have access to information in order to assess risk. Bad loans must be acknowledged. Certain countries with large and attractive markets, such as China and Japan, have managed to achieve a high rate of growth while limiting economic information. Sooner or later, however, the need for accurate information forces the disclosure of data on bad loans as well as other kinds of information, such as the amount of wealth amassed by a ruler's relatives. Such information intensifies pressure for a more open and responsive political system, at least indirectly.

For these and other reasons, universal membership in the multilateral trading system should be seen as an important U.S. political and national security objective as well as an economic one. Postwar statesmen recognized the importance of this historic goal; the end of the Cold War brings it within reach.

The United States also has a strong interest in strengthening and deepening the multilateral trading system in order to enhance its own and others' economic growth and prosperity. As described earlier, globalization dictates the pursuit of three specific commercial objectives. The first is greater *market access* for goods and services, not only for the United States, but also for friends and allies. Such efforts have traditionally focused on lowering or removing tariff and nontariff barriers.

While market access for such goods as steel, semiconductors, and auto parts receives more political attention, trade in services has grown exponentially. The United States is the leading exporter of services. U.S. service exports typically offset over a third of the U.S. deficit in merchandise trade.

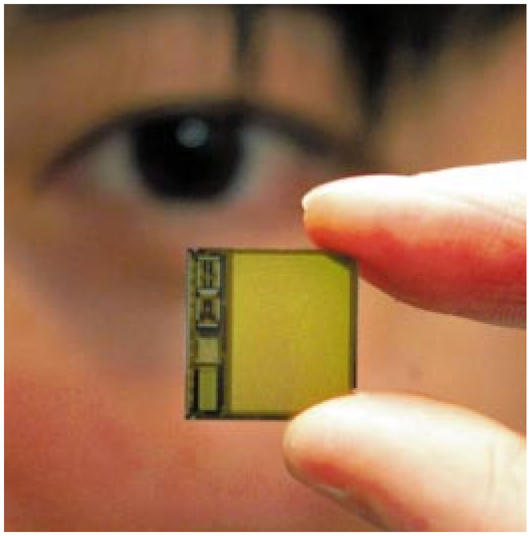
The second priority objective is stronger *rules* to govern the multilateral trading system. For example, there is a need for rules establishing and protecting the freedom of investment. A working group on investment has already been established within the WTO. Another example is the protection of intellectual property. The United States has a competitive advantage in knowledge-intensive, highly innovative goods and services. As U.S. companies disperse such goods and services around the world, they need their knowledge protected. Finally, new rules are needed to address regulatory policy, especially in such areas as competition policy, technical standards, and regulatory procedures governing the testing and certification of goods and services. Such agreements are needed to overcome barriers created by government ownership of companies, excessive regulation, differences in health and safety regulations, and a variety of other domestic measures.

The third key objective is an improved *dispute settlement system.* Broadly defined, this includes stronger rules, monitoring, and enforcement. As previously stated, the Uruguay Round took an enormous step forward, but ambiguities and omissions in the rules still plague the system. (The bitter transatlantic quarrel over bananas is an example.) Monitoring and enforcement are also erratic. Since the United States and the EU initiate the greatest number of dispute settlement procedures, a further strengthening of the dispute settlement system is in the U.S. national interest. It also sets a precedent for conflict resolution in other areas.

Enhancing Global Financial Stability and Growth

In a global economy, two factors in particular argue for a far greater degree of coordination between the United States and other major countries. First, the fiscal and monetary policies of a major country affect others, sometimes drastically. Second, because of the integrated nature of international finance and investment, the United States cannot solve global economic problems alone.

Macroeconomic coordination to date has been carried out through the G-7 and the IMF. At times it has been highly effective, as illustrated by the 1985 intervention to correct the overvaluation of the dollar. In most instances, however, G-7 action has been weak, intermittent, and reactive, especially in the last decade.



AP/Wide World Photos

World's first microchip capable of identifying fingerprints

Asia offers a good example of the need for improved macroeconomic coordination. Because recovery from the crisis depends on the ability of Asian countries to export to other countries, coordination should encompass not only exchange rates but also growth prospects in major markets around the world. The United States should not be the only major purchaser of Asian goods, if only for domestic political reasons.

The problem is that throughout the 1990s other major markets have not been growing fast enough to accommodate a higher level of imports from developing countries. The Asia crisis affects Europe as much as it does the United States; bank exposure, for example, is higher. Yet growth rates in the major EU members have been hovering around 2 percent. Lower growth reduces the likelihood of a buying spree boosting imports from Asia. In fact, the 11 founding members of the euro are projected to run a trade surplus in 1999.

Japan has been in near-recession throughout most of the 1990s. The government repeatedly avoided opportunities to tackle the structural weaknesses that created this situation in the first place. Domestic demand remains sluggish, but industrial capacity is still excessive. As matters stand, Japan is perceived as failing to shoulder its share of the burden of Asian recovery.

On the other hand, Japan has provided significant financial assistance to Asia, bilaterally and through the IMF, and far more than the United States. Moreover, Tokyo has revived an earlier proposal that would establish a major new fund for Asia. In 1998, the Japanese Government finally began to correct weaknesses in the financial system, which should boost prospects for growth.

Acting in concert with Europe and Japan to stabilize and strengthen the international financial system is both urgent and difficult. As yet, no agreement exists regarding what changes need to be made in the governance of the global financial system, let alone what the new international financial "architecture" should look like. There is widespread agreement, however, that stimulating growth and improving the supervision of financial flows are urgent tasks.

Promoting Sustainable Development

As the name implies, sustainable development means focusing on the environmental and social foundations of long-term growth. It includes such measures as environmental protection, the wise use of natural resources, worker rights, health care, and improvement in the status of women.

The challenge is immense. In many countries, growth and overpopulation have led to pollution, depletion of natural resources, and serious social problems. Institutions are weak. Civil society is fragile or nonexistent.

The United States has a substantial commercial interest in successful development strategies. Eighty-five percent of U.S. customers are estimated to live in developing countries. One of the chief components of the U.S. economic boom of the 1990s has been the rapid expansion of U.S. exports to low- and middle-income countries, especially those in Latin America and the Asia-Pacific region. More than two-fifths of U.S. exports go to these regions. In addition, other U.S. interests are at stake in the developing world, such as human rights, the elimination of child labor, preservation of the global environment, and the nonproliferation of weapons of mass destruction.

In an age of economic globalization, sustainable development requires a regulatory framework that establishes and guarantees free and fair competition. Such a framework includes independent oversight, accountability, regulations that are openly developed and readily available, mandatory information disclosure, an independent judiciary, and consumer protection.

Economic globalization tends to force the creation of such institutions and procedures. Becoming globally competitive means discarding the socialist model of state planning, state-owned enterprises, guaranteed employment, import substitution, and other forms of nonmarket behavior. It also requires addressing such legacies as grossly inefficient energy consumption, industrial overcapacity, horrendous toxic waste disposal, and political cronyism. Over time, globalization thus helps place development on a sounder footing.

On the negative side, critics of globalization have asserted that unbridled commercial development can trample on ordinary people's needs. They believe that globalization lowers labor standards, depresses wages, widens the gap between rich and poor, ravages the environment, and deprives poor and indigenous people of their livelihood. They have drawn attention to the absence of social safety nets in many rapidly industrializing countries. They have invoked these concerns to impede further U.S. engagement in the global economy.

No credible evidence identifies economic globalization as the cause of these social evils. Globalization is better understood as a catalyst. The real question is whether globalization ameliorates social problems or makes them worse. The record suggests that the impact of globalization on people's lives depends heavily on whether governments have the right policies in place.

For decades the World Bank and the IMF were confined largely to economic criteria and conditions, in part because of their charters (the IMF charter is particularly restrictive). Yet both institutions now find themselves paying more attention to noneconomic factors, including social safety nets. The World Bank's latest report on the global economy stated, "Looking ahead, it's clear that social policy concerns need to be center-stage along with fiscal and monetary priorities when devising the right response to economic crises."

Sustainable development helps to strengthen democracy and stability. The challenge is to ensure that sustainable development, globalization, and U.S. international economic policy work together, thus enhancing our strategic, commercial, democratic, and humanitarian interests.

Consequences for U.S. Policy

At least five international economic policy issues are directly relevant to the pursuit of these interests: enhancing global economic leadership commensurate with America's superpower status, integrating Russia and China into the global economic system, making effective use of economic leverage, building domestic support for global engagement, and coordinating security and economic policies. None of these corresponds to traditional concepts of U.S. national security, but all are vital to its future.

U.S. Global Economic Leadership

Given the worldwide span of U.S. interests, globalization requires U.S. engagement in the world economy and its governing institutions. Such engagement complements and partially justifies U.S. military ties around the world. Moreover, as the world's only superpower, the United States is the most politically visible country in the world. If it is not seen as part of the solution to the strains associated with globalization, it will be seen as part of the problem.

U.S. leadership is needed in at least two broad areas. First, it is needed to maintain the forward momentum of *trade liberalization*. This means pressing forward with the WTO built-in agenda, scheduled for 1999 and 2000, and engaging constructively in a new round of multinational negotiations early in the next century. Washington must also continue to pursue regional free trade through APEC and the FTAA. Eventually, both the multilateral and the regional track require the administration and the Congress to work toward renewing some form of fast-track authority.

The United States cannot expect to increase access to foreign markets unless it further opens its own. Relative to others, the United States maintains an open economy, but residual barriers exist in several politically sensitive sectors, notably textiles, apparel, and certain agricultural commodities. A number of barriers also remain in place at the state level, especially in the area of government procurement.

The second area that requires U.S. leadership is *institution building*. The WTO, IMF, and other international institutions should be strengthened, properly funded, and made more flexible. This effort should include meaningful provisions for assistance, enforcement (where appropriate), and dispute settlement. Similarly, the International Labor Organization needs better tools to achieve higher labor standards. The

AP/Wide World Photos

An automated teller machine in Buenos Aires

G-7 should be revamped to reflect European unification and expanded to include key developing countries (e.g., Brazil, Malaysia, Mexico, Singapore, China, and India). Strengthened or new arrangements should be considered for environmental protection, macroeconomic coordination, the fight against corruption, and the appropriate use of economic leverage in response to governments that pose security threats or violate international norms.

U.S. leadership in these areas should make itself felt not through hegemony and threats but through persuasion and inducements. There has been a shift from Asian triumphalism to American triumphalism. Boasting about the success of one's own economy is no way to win friends and influence people, especially when there are real social costs associated with the American way. Acknowledging these social problems and finding common ground with other countries is a more constructive approach.

In particular, U.S. negotiators should seek to draw in a new group of countries not hitherto charged with leadership but now deeply involved with globalization. The administration must also involve Congress as an active partner and expand opportunities for public participation.

The United States has an important stake in global governance. It is inappropriate for a superpower to back out of its leadership responsibilities and then complain that other nations are not doing what Americans want them to do. It is equally unseemly to resort to unilateralism and bullying while singing the praises of partnership. Record levels of U.S. prosperity, stemming in part from globalization, should make the task of leadership easier for the United States than for almost any other country.

Russia, China, and the Global Economic System

Integrating China and Russia into the global economic system would help complete the historic, postwar, Western task of creating a truly universal economic community of nations. Creating the conditions for such integration depends primarily on what happens within the borders of these two nations. For both Russia and China, the challenges include fostering genuine competition, deepening deregulation, shutting down insolvent factories and banks, facilitating market entry and exit, curtailing the privileges of the elite, instituting accountability within key institutions, and fostering respect for the rule of law.

The challenge for the West is how to support this transformation most effectively. Integrating the Russian Government into international economic institutions, such as the G-7, is constructive, but does not directly address its domestic problems. U.S. investment in Russian enterprises can help by setting a good example of teamwork, efficiency, and responsible market behavior. Membership in the WTO will be important in the future. Meanwhile, American foreign policy can reinforce positive trends and minimize Russian fears of isolation or encirclement.

China has still not met a basic political criterion of the late 20th century—the peaceful transfer of power. Challenges to its one-party system are still suppressed. But Chinese membership in the WTO should be welcomed. China's leaders are firmly committed to domestic reform despite the threat of massive unemployment. They have maintained a stable currency despite the turmoil in Asia. Bringing China's leaders into multilateral and regional institutions and bilateral discussions increases pressure for internal reform and outweighs the perceived disadvantages of legitimizing the repressive aspects of the current regime. Direct dealings with China enhance stability by taming and encouraging peaceful economic diplomacy in APEC and elsewhere.

Critics allege that doing business with China represents the triumph of greed over ethical and national security considerations. But engaging in trade and investment exposes more Chinese to Western business practices, which on the whole are honest, relatively humane, and based on merit. Such engagement works against mercantilist thinking and creates more stakeholders in Beijing's shift toward capitalism. It also creates pressures for freedom of information. The danger of economic blackmail is small because American firms' ability to survive a sudden cutoff in economic relations is far greater than the ability of China to apply Western technology in the event of such an interruption. Illicit technology transfers will remain a problem in China (and elsewhere), but being "on the ground" will reduce the likelihood that technology will be diverted for unauthorized ends.

There is one realm in which the economic integration of China and Russia seemingly harms U.S. interests—the proliferation of advanced weapons technology. Globalization, however, is not the source of proliferation. It is classical *realpolitik* that has motivated Chinese nuclear cooperation with Pakistan. China's behavior is a long-standing strategic response to the relationship between the former Soviet Union and India. In Russia's case, the much-publicized "yard sale" of weapons and nuclear materials reflects impoverishment and unemployment within the Russian military establishment, which stems in turn from the inability of the government to establish a healthy economic framework.

It is up to Beijing and Moscow to decide whether they can live by WTO rules and adapt other policy changes commensurate with globalization. Nevertheless, Washington can help by minimizing partisan politics and resisting the political tendency to hold trade hostage to other goals. More tangible steps could include providing more technical assistance to strengthen competition policy, develop sound business practices, and train financial and legal professionals in areas such as risk assessment and asset valuation. Inviting China to join a restructured G-7 would both symbolize and encourage China's shared responsibility for maintaining the international economic system.

By far the most visible step that the United States could take, however, would be to bring to an end the annual ritual extending Most Favored Nation (MFN) treatment to China and Russia. Even the most distinguished American newspapers sometimes equate MFN status with trade "privileges." Despite its name, MFN means normal tariff treatment—the level of tariffs extended to all but a handful of countries. For that reason, MFN is increasingly referred to as "Normal Trade Relations" (NTR). Non-NTR tariffs are punitive, ranging from 50 to 200 percent. Forcing the President to seek NTR from the Congress every year does not give Americans any leverage over Chinese decisionmaking; it merely underscores America's perceived inconsistency and demonstrates what Chinese leaders see as a key weakness of the American system of government. Subjecting China to WTO rules would be far more effective.

Effective Use of Economic Leverage

The question of how to use U.S. and allied economic leverage effectively arises most noticeably in the case of rogue governments. One school of thought argues that trading with countries ruled by such governments increases national wealth and thus eases the burden of military spending. The implied corollary of this same argument is that isolating and even starving the citizenry of a rogue government will bring about either a turn toward moderate behavior or some form of pro-Western coup d'etat.

The opposing school of thought emphasizes that sanctions typically don't work. Indeed, they can make matters worse by reinforcing the dictator's anti-Western policies, further impoverishing the poor, and whipping up even more anti-Americanism. In addition, they anger our allies and hurt U.S. firms and workers. In the medium to long term, engagement in the global economy is more likely to bring about the desired results.

In weighing these arguments, U.S. leaders in Congress and the executive branch need to review the historical record and devote careful thought to the security implications of economic sanctions, especially unilateral sanctions mandated by laws whose "bite" transcends U.S. jurisdiction. Whatever the merits of these laws may be, they polarize domestic interests and tie up the political system in frequently unproductive ways. With respect to allies and other friendly countries, they divert enormous amounts of time and energy to bitter disputes over sanctions at the expense of other goals. Such conflicts are not just diplomatic flurries; they affect real security interests. Effects of this kind can be anticipated and should be estimated in advance, so that goals can be carefully and realistically defined, alternative measures fully explored, and costs accurately evaluated.

A similar effort needs to be made with other countries. Economic sanctions are normally far more likely to succeed if they are multilateral.

Dedication ceremony for the 100th Boeing 747 for Japan Air Lines

Associated Press

There is a need for more comprehensive and structured multilateral coordination, perhaps through a working group of the G-7. A review procedure that involves the closest neighbors of the targeted country is also in order. Whether such an effort works or not, all proposed U.S. sanctions should receive a more thorough historical and strategic review than they do now.

Domestic Support for Global Engagement

U.S. leaders must do a better job explaining the benefits of globalization and addressing its costs then they have to date. Ultimately, globalization is consistent with America's values and plays to its strengths. But legitimate social and economic concerns must be addressed, primarily through better education and training and more flexible social and employment benefits.

Engagement in the global economy requires the active participation of Congress, state, and local authorities, and nongovernment groups. At present, an odd alliance among unions, environmentalists, and conservative isolationists has stymied the President's request for new trade agreement authority, delayed U.S. contributions to both routine IMF replenishment and the special financial assistance package for Asia, and postponed payment of long-overdue U.S. dues to the United Nations. What the rest of the world sees is not a commitment to engagement, but fractious partisan squabbles that undermine U.S. credibility abroad.

The two chief policy imperatives are education about the global economy and response to legitimate social concerns. American leaders must do a better job of explaining the benefits of globalization to skeptical voters. More and more Americans get their international news from television rather than from newspapers, but television coverage of international news has been speeded up and dumbed down. Polls reveal that Americans know remarkably little about trade. Solid majorities believe that trade reduces the number of jobs (this despite the *gain* of 13 to 14 million jobs since 1993). Newspapers report on job losses associated with imports but not on job gains associated with both exports and imports. They tend to focus on the monthly merchandise trade deficit rather than the total goods and services deficit (which is considerably less), and they usually fail to point out that such deficits are equivalent to only a fraction of America's huge GDP (20 percent in 1998).

Nevertheless, globalization also gives rise to legitimate concerns about social justice and civil society, both in the United States and abroad. Layoffs are inevitable in a market economy. But in many countries, genuinely free labor unions—now taken for granted in Western market economies—are not allowed to exist. In countries forced to swallow IMF medicine, bankers and generals get away with their mistakes, while the poor suffer. In the United States, employment statistics alone do not address such intangible factors as quality of work, the health of communities, and economic insecurity. Offsetting social policies, such as portable health insurance and better training opportunities, would help. Similarly, the income gap should be addressed and debated.

The idea is not to kill the globalization goose but to distribute its eggs somewhat more evenly. The long-term path to higher incomes lies through better education; the short-term path has to do with an improved safety net, more effective community assistance, and better training. A rich country like America can do more to empower people to find a place in the global economy, both at home and abroad.

Security and Economic Policy Coordination

Both U.S. security and economic policies are powerful instruments for shaping the global environment and hence the future of human society, but they sometimes operate at cross-purposes. In order both to facilitate globalization and to cope with its dangers, the national security community may want to consider taking part more actively in the making of international economic policy and to review its own policies in that light. Recent history suggests that U.S. trade negotiators, financial authorities, and development officials, on the one hand, and national security planners on the other, need to be much more aware of each other's concerns than they are now.

For example, the national security community might do its part to help ensure that IMF funding is adequate to restore confidence in troubled economies and maintain adequate reserves, and that the IMF is fully responsive as an institution to unique circumstances in each country. If measures to limit the extreme volatility of currency movements come under consideration, national security planners may wish to be at the table. Country risk assessments associated with national security goals (e.g., base agreements) must take into account the real value of currencies, the underlying macroeconomic fundamentals, and the prospects for destabilizing short-term currency movements. Arms sales should be reviewed more comprehensively. (The one silver lining in the Asian crisis is that it dampened an incipient arms race in the region.) Sustainable development must be taken seriously and supported throughout the entire U.S. policy community.

Initially, a structured and sustained effort to bridge the communications gap between economics and security—sponsored jointly, perhaps, by the National Economic Council and the National Security Council at the direction of the President—will stir up a bureaucratic culture clash. But the two policy communities will find that, by pursuing common interests, they will add up to more than the sum of their parts—to the benefit of U.S. foreign policy as a whole. Sooner or later, it may be appropriate to merge the National Economic Council into the National Security Council, to form a single National Policy Council, or something like it.

There are similar, powerful reasons why the national security community may wish to join the globalization debate in the public domain. The argument for globalization is compelling, and its benefits are manifold, but its short-term risks are real, and the domestic political threat to U.S. engagement has reached uncomfortably high levels. Both Congress and the public have always responded well to the case for international engagement based on national security, and they are likely to do so again.

Net Assessment

In general, economic globalization continues to bolster U.S. national security by facilitating global integration, contributing to long-term peace and stability, promoting prosperity and competitiveness at home, and enlarging the democratic core beyond the West. Globalization is a harsh taskmaster, but by forcing the pace of needed adjustment at home and abroad, it ultimately puts national security on a stronger footing.

Thanks to sound macroeconomic policies and flexible capital markets, the United States is well positioned to compete in the global economy. Thanks to geography, the United States is at the hub of regional trade with both Asia and the Americas. European economic and monetary integration and expansion are fully consistent with U.S. interests. More and more countries are turning toward market-oriented policies as well as toward the political and institutional frameworks needed to ensure the success of those policies. Active U.S. engagement in the global economy not only protects U.S. commercial interests, but also contributes to this positive evolution.

At the same time, global economic forces have had disintegrative effects that undermine certain U.S. national security objectives. In countries with political and structural weaknesses, short-term shocks associated with globalization—notably rapid financial flows—can impoverish large numbers of people, robbing the middle class of their livelihood and the poor of their meager subsistence. These dislocations can undermine political stability, engender social and ethnic violence, and exacerbate anti-Americanism.

This challenge highlights at least three major U.S. interests: strengthening and deepening the multilateral trading system, enhancing global financial stability and growth, and promoting sustainable development. Policy consequences include more effective U.S. leadership, integration of Russia and China into the global economic system, using economic leverage wisely, enhancing domestic support, and bringing international economic and security policies into closer alignment.

Successful pursuit of these interests suggests the need for close coordination between the economic and security policymaking communities. The priorities of each side must be understood, if not shared, by the other. Actions must be carefully weighed to ensure that they reinforce a healthy economic-security nexus. Except in an emergency, no single priority should overshadow all the others. At the same time, priorities should be roughly ranked so that they fit into a comprehensive strategy.

This is a tall order. It is difficult enough to devise and execute economic policy or security policy in isolation from one another. Both communities should consider adopting shared, strategic criteria of success, supported at the highest levels of government and communicated to the public, so that they can surmount both the daily demand for "deliverables" and the overwhelming crush of meetings and paperwork. Developing such a strategy will require unprecedented understanding and sophistication.